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THE COMPETITION ACT
&
THE CANADIAN TELECOMMUNICATIONS INDUSTRY

ADDRESS BY
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THE *COMPETITION ACT*

TO

INSTITUTE FOR INTERNATIONAL RESEARCH
TELECOMMUNICATIONS CONFERENCE

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I would like to thank the Institute for International Research for this opportunity to speak to you today. The agenda for this conference is fascinating--it truly reflects the profound changes under way in the Canadian telecommunications industry.

So great are these changes that they have succeeded in doing the impossible--the infamous information highway has made competition and antitrust law a glamorous and trendy field of endeavour. Articles on the subject appear regularly in the *New Yorker* magazine, as well as the *Competition Policy Review*; *Time* and *The Atlantic Monthly*, as well as *The Financial Post*. There have even been cartoons in the *New Yorker*--I almost brought some visual aids with me today.

As you all know, over the past four years there has been a shift towards increased private ownership of telecommunication enterprises. The patchwork federal-provincial regulation of major telephone companies has given way to almost exclusive federal authority.

Furthermore, the passage of the new *Telecommunications Act* last year, and the recently completed CRTC regulatory framework hearings, mean that we can also expect to see major changes in the way the telecommunications industry is regulated.

There have been other recent and significant changes as well: the public long distance market is now open to facilities-based competition; a number of international alliances between Canadian carriers and large U.S. telecommunications firms have been created; and, through the formation of the Stentor alliance, the operations of provincial and regional telephone companies have become increasingly centralized.

I will point out here that, as many of you are aware, a number of competition concerns have been expressed to the Bureau regarding the establishment of Stentor and the Master Supply Agreement for telecommunications equipment between Bell Canada and Northern Telecom. The Bureau has indicated on other occasions that it is examining these arrangements in light of the provisions of the *Competition Act*. Due to the confidentiality requirements of the Act, I cannot comment of the status of these examinations, other than to confirm that our work is ongoing.

As I have indicated, the groundwork is laid for even further changes in the telecommunications industry. Indeed, an impressive list of speakers will address some of these key emerging issues at this Conference: cable/telephone convergence, the "open network" environment, strategic alliances and the information highway.

Advancing technology is clearly the agent of change in global telecommunications markets. The traditional telecommunications industry and its regulation have been based on structural and economic assumptions that are rapidly being undermined by technological change--not only in Canada, but around the world.

Telecommunications markets are becoming increasingly competitive. Regulation is giving way to market forces as the best means to ensure that users have access to high quality, innovative services at competitive prices.

Technological change and the move from regulation towards greater competition have important implications. Implications not only for those who are directly involved in the telecommunications industry or who rely on it in their businesses, but also for government policy makers, regulators and other government agencies, including the Bureau of Competition Policy.

In my remarks this morning, I hope to give you a sense of how the Bureau views some of these emerging issues, and of how its role affects the industry.

First, a bit of historical perspective. I won't dwell on the past, but I think it is important to remind you that the promotion of competition in Canadian telecommunications markets has been a Bureau of Competition Policy priority for at least the past twenty years.

The Director's office has made numerous interventions over the years to the CRTC and other regulatory bodies. It has advocated liberalized competition with respect to, among other things, terminal attachment, equipment supply, resale and sharing, and public long distance service. The Director has strenuously and consistently represented the benefits of competition in the provision of

telecommunications services, most recently in the CRTC's Review of Regulatory Framework Proceeding, 92-78.

I intend to continue to make the issue of competition in the telecommunications sector one of our major priorities. The Bureau is currently involved in a number of matters relating to the telecommunications industry, and our level of intervention and enforcement activity will likely increase over the coming months. We are re-evaluating our resource commitments to this sector in order to meet the challenges which lie ahead.

One of those challenges might well have to with the convergence of the telephone and cable television industries, but first let me say a few words about another type of convergence: the convergence of regulation and competition law. The passage of the new Telecommunication Act last year will, as the Commission exercises its new powers, expand the applications of the *Competition Act* to activities in the telecommunications industry. This is an issue of very real interest to the Bureau, as I am sure it is to those of you in the industry, and to users of telecommunications services.

Let me stress that competition law is fundamentally different in approach and application from regulation. The *Competition Act* is a general law of general application, which pertains equally to all industries: from transportation, to the manufacturer of shoes, to telecommunications. The Bureau of Competition Policy is principally an investigative agency, charged with enforcing that Act. To affect change, the Director must go to the courts, the Competition Tribunal, or regulatory bodies such as the CRTC. Within the government, the Bureau has also been an advocate for competition--it has carried the torch by supporting policy and legislative changes to promote competition, efficiency and deregulation in a number of key infrastructure sectors, including energy, transportation and telecommunications.

Unlike economic regulation, competition law does not involve prior approval for a course of business conduct. Competition authorities do not regulate levels of service,

quality, prices or profits. Rather, these outcomes are determined by the influence of competitive market forces. Under the new *Telecommunications Act*, this type of competition will supplant the role of regulation in determining choice, quality and prices for services in the Canadian telecommunications marketplace.

The *Competition Act* establishes the boundaries between what Parliament has defined as acceptable and unacceptable business conduct. Within these boundaries, firms are free to seek out market opportunities and conduct their affairs as they see fit. The role of the *Competition Act* and the Bureau's enforcement activity is to prohibit activities that impede competition or entry into an industry. Competition law seeks to create an economic environment in which firms can test their entrepreneurial skills, and consumers can derive the benefits which competition can deliver. I would echo a recent comment made by the Chairman of the U.S. House Judiciary Committee that, "antitrust law should mean opportunity for all and security for none".

The convergence of competition and communications policy could have significant implications for the telecommunications industry, particularly in the area known as forbearance. The *Telecommunications Act* requires the CRTC to forbear, or to hold back, from regulation where it finds that a service or class of service is or will be subject to sufficient competition to protect the interests of users. The Act also authorizes the Commission to exempt classes of Canadian carriers from its provisions, where doing so is consistent with Canadian telecommunications policy objectives. The Bureau will take an active interest in the CRTC's exemption and forbearance proceedings and will intervene before the Commission where appropriate.

The position which I have advocated to the CRTC in the recently completed framework proceeding is that any decision made on forbearance should balance two things: the degree to which the incumbent telephone companies possess "market power", against the costs of continued regulation.

Regulation imposes direct administrative costs upon the government, the regulator and the regulated parties. These costs are ultimately passed on to subscribers

and to taxpayers. Moreover, the fact that regulation can discourage risk-taking and stifle the emergence of dynamic competition and innovation is also of great concern. Regulation also tends to inhibit competition by denying regulated firms the pricing flexibility needed to react to changing market conditions.

Therefore, I do not believe that it is necessary to find an absence of market power in order to conclude that there is sufficient competition to warrant forbearance from regulation. It has to be recognized that, at some point short of perfect competition, the costs of continued regulation will exceed the costs of relying upon market forces. Regulation should only remain where it is clearly demonstrated that the net benefits of regulation are greater than the net benefits of relying upon market forces.

Indeed, in an industry as dynamic as telecommunications, where the pace of change seems to be constantly accelerating, it is inconceivable that regulators could be expected to make better decisions as to service offerings and prices, than those that would be determined by competition.

The transition from regulated to unregulated markets will not occur overnight. There are some areas--principally local service and access to bottleneck facilities controlled by the telephone companies--where continued regulation by the CRTC is likely to be required for some time. Indeed the terms and conditions of competitive access to essential facilities are crucial to the whole question of competition in the telecommunications industry.

In my view, the CRTC must increasingly perform the role of a facilitator of competition, and shift away from the regulation of individual rates and services. This shift of emphasis has already been reflected in a number of the Commission's decisions, notably decision 92-12 to allow for competition in public long distance service. It will no doubt continue to be evident as the Commission addresses future issues relating to convergence and the information highway.

Users will also have to adjust to the realities of increasingly competitive and less regulated markets. The Bureau of Competition Policy cannot serve as a "telecom complaints office". Users will have to exercise their power of choice to enhance their own welfare and impose competitive discipline on service providers.

As Director of Investigation and Research, I recognize that the feasibility and attractiveness of regulatory forbearance depend in part upon the effectiveness of competition law as a deterrent to potential anti-competitive behaviour.

As I said earlier, the *Competition Act* is a law of general application. It applies to all sectors of the Canadian economy, except where specific exemptions exist either within the Act or in other legislation. The Act is not industry specific; it applies to particular forms of business conduct across all industry sectors.

Canadian competition law jurisprudence in the criminal law context, however, has developed a doctrine which has become known as the "regulated conduct defence." The gist of the regulated conduct defence, as many of you are aware, is that specific activity which is authorized or carried out pursuant to a valid scheme of regulation is deemed to be in the public interest. As such, it cannot be found to be in violation of the criminal provisions of the *Competition Act*.

It is important to underscore that the regulated conduct defence is only a defence, and not an exemption to the *Competition Act*. It is also important to recall that the regulated conduct defence was developed in the context of the primarily criminal law provisions of the former *Combines Investigation Act*; there is no similar jurisprudence with respect to the civil provisions of the *Competition Act*.

My expectation is that the competition issues in the telecommunications industry will be more likely to involve the civil rather than the criminal provisions of the Act. The criminal law provisions seek to punish firms by imposing fines and other penalties for past business conduct, often of a covert nature. The civil provisions, while they also deal with past conduct, provide greater scope for assessing and balancing complex economic questions related to efficiency and market power, and for implementing

remedies to alter future conduct. Civil provisions relating to abuse of dominance may be particularly relevant, as I will later explain.

Obviously, questions as to the scope of the application of the *Competition Act* become more pressing when regulatory schemes are in the process of evolving towards greater reliance on market forces. The co-existence of effective competition law enforcement and economic regulation is not without precedent. For example, section 265 of the *National Transportation Act* expressly provides that nothing in that Act affects the operation of any other Act of Parliament, such as the *Competition Act* or foreign investment review legislation, in respect to mergers and acquisitions in the transportation sector.

I should point out that under the *Telecommunications Act*, resellers, and others who provide telecommunications services but are not "Canadian carriers" within the definition of the Act, are not subject to regulation. Their activities are clearly subject to the full application of the provisions of the *Competition Act*.

The co-existence of antitrust law and regulatory policy has also been long recognized by the American courts. The United States Justice Department litigation in the 1970s against AT&T and the continued role of Judge Greene illustrate the significant effect that competition law can have, despite the existence of an extensive regulatory regime.

In Canada, the courts and the Competition Tribunal must decide the full scope of the application of the *Competition Act*. In doing so, they will effectively decide whether society would be better served by competition law and policy, or by some other means of determining prices, outputs and entry.

The challenge in coming months and years will be to work out the details of the competition law and regulatory co-existence in a coherent and rational manner. This will require increased communication, consultation and cooperation between the Bureau of Competition Policy and the CRTC. The Bureau is prepared to work with the Commission, as it is with members of the industry, in order to minimize

uncertainty which may exist over jurisdiction, and to facilitate the resolution of competition issues.

I believe that, as Canada lessens its dependence on regulated telecommunications, the importance of effective competition will likely increase. In the recent budget debate the Honourable John Manley, Minister of Industry, observed that Canada "needs competition and consumer protection laws that enhance the proper functioning of the marketplace, while enabling Canadian businesses to achieve the critical mass necessary to take on the world." These remarks reflect my own view that, while increased international trade within the global economy will improve the efficiency and competitiveness of Canadian industries, there remains an important role for competition law in ensuring that the public interest in competition is protected.

To be effective, the enforcement of competition policy in the telecommunications sector must accomplish at least three things. First, it must afford the industry the flexibility to operate and adjust to changing market conditions. Second, it must help ensure that the transition to competitive markets is not unduly delayed. Third, competition policy has to establish the parameters of acceptable business practices without directly controlling market behaviour. With regard to the latter, the provisions of the *Competition Act* dealing with abuse of dominance, mergers and conspiracies are extremely important, and I would like to talk about them briefly.

In the context of competition law enforcement and deregulation, perhaps the greatest challenges arise in situations where highly concentrated industries operate in fields that are subject to a lesser degree of regulation, and where one or more large firms dominate. This is precisely the situation which exists in the Canadian telecommunications industry. There, in contrast to many other sectors of the Canadian economy, foreign competition and the removal of trade barriers cannot necessarily be expected to provide significant competitive discipline on incumbent firms.

Concerns over market dominance require a framework law that clearly defines those practices which are abusive and may be subject to remedial action. The

Competition Act's abuse of dominance provisions are applicable to a broad spectrum of anti-competitive practices. These include exclusive dealing, market foreclosure through vertical integration, the control of scarce facilities, predatory pricing, non-price predation, and a wide variety of contractual practices that tend to have exclusionary effects or otherwise limit competition. These provisions have allowed the Bureau to remedy specific contractual terms or business practices of dominant market participants, and to mitigate the damaging effects of such practices on competition.

The abuse of dominance provisions require the Competition Tribunal to consider whether a practice which results in a substantial lessening or prevention of competition is the result of superior competitive performance. If such is the case, the Tribunal does not intervene. The Act thus provides a flexible and balanced tool to deal with anti-competitive abuses by dominant firms.

The same is true of the Act's merger provisions. Their merger review procedures were crafted to facilitate, rather than inhibit, pro-competitive or neutral structural adjustment in the marketplace. Enforcement is directed at forestalling only those mergers that would have the net effect of substantially lessening or preventing competition in Canadian markets, and which do not give rise to offsetting efficiency gains.

Unlike other provisions of the Act which involve an examination of the effects of current and past business conduct on competition, merger analysis is less static. It involves an assessment of the likely future effects of mergers and acquisitions on competition. In rapidly changing industries such as telecommunications, it may be less important to focus on the potential effects of a particular transaction on existing levels of competition. Instead, it could perhaps be more helpful to look forward, and consider if the transaction would likely "prevent" future competition that might otherwise come about as the result of technological expansion.

Market share and industry concentration are important considerations in a merger review. However, the Act specifies that market share or industry concentration

are not, in themselves, the exclusive criteria which define a substantial prevention or lessening of competition. Other dynamic considerations also apply; these include barriers to entry and the nature and extent of innovation in a relevant market.

The effects of innovation and technological change are, as I will discuss later, perhaps the most important factors affecting competition in the telecommunications sector. They are considered not only in relation to merger assessments, but in all aspects of potential enforcement in this industry.

The evaluative factors used by the Bureau in assessing mergers are deliberately very broad, to allow for a balancing of the pro- and anti-competitive effects of any proposed merger. They include an efficiency exception to allow mergers which would otherwise be prohibited because they substantially prevent or lessen competition. The efficiency exception recognizes that, in some cases, the efficiencies of a merger can be great enough to offset the negative effects of diminished competition.

The protection of fair competition is also the goal of conspiracy enforcement. The conspiracy provisions of the Act make it a criminal offence for parties to enter into agreements or arrangements which have the effect of unduly preventing or lessening competition. The Bureau has long considered conspiracy and bid-rigging to be among the most serious offences under the Act. In 1986 Parliament increased the maximum fines for conspiracy to $10 million. Prison is also a possibility.

The enforcement of the conspiracy provisions has been and will continue to be directed at price fixing, market sharing and other arrangements among firms which have the prohibited effect of unduly preventing or lessening competition.

Although strategic alliances are not directly referred to in the Act, these types of arrangements can be reviewed under the criminal conspiracy provisions of the Act. In the recent past we have seen a number of strategic alliances in the telecommunications sector. Some of these involve Canadian telecommunications firms aligning themselves with U.S. carriers, others are implemented at the domestic level. These alliances have fostered technology transfers, infusions of investment capital and the more efficient

utilization of management expertise. Because they strengthen the position of firms in the Canadian market, these alliances are in many respects pro- competitive.

However, strategic alliances that take the form of horizontal arrangements can, potentially, have a detrimental impact on competition.

Parties entering into strategic alliances should not only consider the benefits which they may realize from such arrangements, but also the effects of such alliances on competition. If competition concerns could raise an issue under the Act, parties might wish to consider other arrangements. They may also wish to consult with the Bureau beforehand to obtain an advisory opinion.

The Bureau has no interest in unnecessarily forestalling strategic alliances which may have neutral or positive effects on competition. However, where competition concerns arise, the Bureau will address them under the conspiracy or other appropriate provisions of the Act.

Where substantive issues arise under the provisions of the Act, the Bureau's objective is to deal with them in a timely, forceful and transparent manner. In terms of the telecommunications industry, we recognize that markets are dynamic and that the future course of business strategy and competition will be shaped by technological developments.

As I mentioned earlier, "innovation" is one of the factors which we, as competition authorities, must take into account--in our analysis of markets, and in our assessment of the effects of mergers and other activities on competition in a given market. And, when I refer to "markets", I should stress that the Bureau defines relevant markets in terms of the commercial realities of actual or potential supplier and customer interaction. Geographic markets for the purposes of competition analysis seldom conform to political boundaries.

Technological change can drastically alter the definition of relevant anti-trust markets. There is perhaps no better example of this than the potential effect on competition of the convergence of telephone, cable, broadcast, wireless and computer

technologies. Technological change and innovation can broaden the definition of relevant markets, increase the opportunities for competitive entry, and constrain the exercise of market power by incumbent firms.

Technological change, even in the context of what is occurring in the Canadian telecommunications industry, does not, however, obviate the need for competition law enforcement, or for specific forms of regulation. Technological change does not eliminate the incentives for firms to engage in anti-competitive conduct. Dominant firms will continue to have incentives to constrain new forms of competition. As long as the telephone companies remain vertically integrated and in control of essential facilities, competition law and regulation will continue to play a role in creating and preserving the conditions for competitive entry into the industry. As regulation is diminished, the *Competition Act* may increasingly be relied upon to address the key issues of access and entry.

Consider the so-called information highway. In the Speech from the Throne, the government expressed its commitment to implementing a Canadian strategy for an information highway. In a similar vein the Honourable Jon Gerrard, Secretary of State for Science, Research and Development, made some relevant comments to the recent "Powering Up North America" conference. He observed that in Canada firms in the telecommunications, broadcasting, cable and information industries have operated in separate markets, without the benefits of either competition or collaboration. He asserted that this lack of competition had resulted in Canada's falling behind the U.S. in the provision and pricing of advanced telecommunications services. The Minister indicated that in order to correct this, the government would adopt a pro-competition approach to the development of the information highway.

As Director of Investigation and Research, I share the government's interest in developing a pro-competition approach to the creation of the information highway. Government policy should seek to ensure that the resulting information marketplace

will provide the widest opportunity for competition in the provision of services to customers.

The government's strategy for the information highway will be advanced over the next few months. As I see it, a pro-competition approach to the information highway must include six elements.

First. Legislative and regulatory impediments to competition--such as line of business restrictions imposed upon telephone companies, cable companies, broadcasters and others--will have to be reduced or eliminated. Firms should not be prevented from exploiting their relative technological and management strengths in the marketplace. In a competitive situation, firms must be free to seek out market opportunities on the basis of their own assessments of the risks of failure and the potential rewards.

Second. Where any firm--telephone, cable or whatever--controls network facilities which are essential for competitive entry, obligations need to be created for these firms to provide open access to such facilities on a non-discriminatory basis. These obligations should involve the development of common standards, open network architecture, co-location and unbundling of required services. Control of network facilities and proprietary standards should not be used to disadvantage rivals to the detriment of competition.

Third. Policies permitting telephone and cable companies to expand their range of services must also include requirements for them to provide network capacity to unaffiliated program and service providers on a nondiscriminatory basis. Given the incentives for vertically integrated firms to favour their own services, appropriate safeguards, which could include some form of structural separation, will have to be designed and implemented.

Fourth. To the extent that collaboration and cooperation among various industry participants is needed to develop the information highway, supervision will be required to ensure that any such arrangements do not involve anti-competitive market sharing, or otherwise go beyond what is necessary to facilitate interconnection and open access.

Fifth. It would appear that competition is most likely to occur between cable and telephone companies. Therefore, mergers and acquisitions involving these firms, particularly in the same geographic market areas, will have to be the subject of very close scrutiny. I note that in the United States the Clinton Administration is proposing to prohibit telephone companies from acquiring cable systems in their local exchange areas. While there could be exceptions to this measure in rural or remote areas, the policy's objective as I understand it is to promote and preserve alternative, competing carriers in geographic and service markets.

Sixth. As the information highway develops, options will emerge over time for competition in local telephone service. In order to induce efficient entry to the local loop, the current policy of pricing local service/access below cost and relying upon substantial contributions from long distance service will have to be reconsidered.

To sum up, I believe that we are well past the point of debating whether competition or regulation is the best means of providing the public with innovative telecommunications services at competitive prices.

The new *Telecommunications Act* signals a clear preference for competition as the driving force in the telecommunications industry. That is not to say that there is no longer a role for regulation. However, the role of regulation is evolving away from the control of rates, profits and levels of service, and towards the facilitation of competition through the establishment of nondiscriminatory access to bottleneck facilities. The technological change which is leading to convergence and the information highway will further expand the horizons for competition.

No one can predict with certainty where the forces of technology and competition will take the industry over the next few years.

In this era of rapid and profound transformation, it is especially important for the Bureau to understand the changes which are taking place in telecommunications, and their consequences for competition. In this regard I am committed to maintaining an open dialogue, and to working with industry participants and users. I want to

ensure that applications of the *Competition Act* to this important sector of our economy are informed, responsible and, above all else, effective in protecting the public interest in competitive markets. Thank you.